INITIAL STATEMENT OF REASONS FOR PROPOSED REGULATORY ACTION

Specific Purpose, Problem, Rationale, Benefits [Gov. Code, § 11346.2, subd. (b)(1)]

Summary

The Department of Financial Protection and Innovation, formerly the Department of Business Oversight, ("Department") licenses and regulates escrow agents under the Escrow Law (Fin. Code, §17000 *et seq.*).[1] Under the Escrow Law, it is unlawful for an escrow agent to conduct business without first applying for and securing a license from the Commissioner of Financial Protection and Oversight, formerly the Commissioner of Business Oversight, ("Commissioner") unless the escrow agent is exempt from licensure.[2]

Section 17409 further requires all moneys placed in escrow to be deposited in a non-interest-bearing demand or checking account in a bank insured by the Federal Deposit Insurance Corporation and approved to receive such moneys by the Commissioner. Such funds, when deposited, must be designated as "trust funds," "escrow accounts," or with a name that indicates the funds do not belong to the escrow agent.

Section 1732.2 of title 10 of the California Code of Regulations[3] sets forth what books and records an escrow agent is required to establish and maintain regarding its escrow accounts and specifies how often they must be reconciled. The regulatory action proposes to amend subsections (a)(2) and (a)(3) of section 1732.2 to clarify how the requirements apply to current business practices.

Section 17404 of the Escrow Law requires every person subject to the Escrow Law to keep and use in its business books, accounts, and records which will properly enable the Commissioner to determine whether the escrow functions performed by such person comply with the provisions of the Escrow Law and rules. Specifically, section 17403.5 of the Escrow Law provides that: (1) all required records may be maintained by Internet escrow agents and submitted to the Commissioner electronically; (2) all transfers by Internet escrow agents between accounts may be made electronically; and (3) customer account statements may be sent by Internet escrow agents via email or the Internet.

Section 1737.3 requires escrow agents to preserve records for at least five years from the close of escrow. Additionally, section 1737.3 allows an escrow agent to retain and provide the records, which it must establish and maintain, to the Commissioner in an electronic format if the records are maintained and provided in a format that allows the Commissioner complete access to all of the books, accounts, and records. This rulemaking proposes to amend subsections (a) and (b) of Rule 1737.3 to clarify how they

---

[1] Further statutory references are to the Financial Code, unless otherwise indicated.
[2] Fin. Code, §§ 17006, 17200.
[3] Use of the term "rule" in this initial statement of reasons refers to the California Code of Regulations.

apply to current business practices. It will also add subsection (c) to define the term "statement of account" as requested by the escrow industry.

Section 17406 of the Escrow Law requires each escrow agent to submit annually a report containing audited financial statements and any additional relevant information that the Commissioner requires. Section 1741.5 sets forth the content of reports and financial statements, and procedures for independent accountants performing the audit.

This regulatory action proposes to redraft section 1741.5. The proposed amendments to section 1741.5 restructure and amend the existing rule to clarify that the annual report must consist of both an audit of financial statements, with an unqualified opinion by an independent CPA, and supplementary information, using agreed-upon procedures in accordance with national attestation engagement standards, by an independent CPA, when completing the annual report.

In addition to amending section 1741.5, this regulatory action proposes to add section 1741.5.1. Under section 17600 of the Escrow Law, a licensee ceasing to engage in business must submit a closing audit to the Commissioner that contains the information required by the Commissioner. Existing regulations do not set forth procedures for the closing audit, however. Proposed section 1741.5.1 would set forth procedures for the closing audit.

The purpose of this regulatory action is to revise section 1741.5 to conform to the professional standards of a CPA, as more fully described below, and to adopt a regulation implementing section 17600 regarding the closing audit.

Section 17003 of the Escrow Law defines an "escrow" as any transaction in which one person, in order to sell, transfer, encumber, or lease real or personal property to another person, delivers a written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held until the happening of a specified event or the performance of a prescribed condition, at which time it is delivered to a grantee, grantor or its representative. The definition of "escrow" does not specify if it includes "holding and disbursing funds under an assisted reproduction agreement." Family Code section 7961 specifically requires that these transactions be handled by a licensed independent escrow company. Currently, the companies that handle such transactions have been found to be in violation of the Escrow Law provisions because they did not believe such transactions were covered under the Escrow Law. To address this uncertainty in the law, the rulemaking would clarify that such transactions are escrows. This would enable the Department to regulate such transactions and ensure the consumers receive the protection of the Escrow Law.

Section 17420 of the Escrow Law prohibits escrow licensees from paying over to any other person any commission, fee, or other consideration as compensation for referring, soliciting, handling, or servicing escrow customers or accounts. The compensation language is vague because "consideration as compensation" may be interpreted in many ways, including discounting and waiving escrow fees. Licensees

have complained that the lack of clarity in what constitutes “compensation” has made it difficult for them to do business with certainty that they are not in violation of the Escrow Law; and, similarly, the Department has been reluctant to take administrative action against companies paying referral fees and kickbacks. To address this vague language, the rulemaking would clarify “consideration as compensation” by plainly describing what constitutes an act of referral for business similar to the provisions in the Insurance Code and bring more certainty to the industry.

BACKGROUND

Until December 31, 2001, section 17405 of the Escrow Law required the Commissioner to conduct a routine regulatory examination of every escrow agent licensee at least once every other calendar year. The purpose of the examination is to determine whether an escrow agent is in compliance with the Escrow Law and the rules promulgated thereunder, predominantly for the protection of the public’s escrowed funds held in trust by the escrow agent.

In 2001, AB 459 (Stats. 2001, ch. 499) amended the Escrow Law to, among other things, change the frequency of the routine regulatory examination to as often as the Commissioner deems necessary and appropriate, but not less than once every 48 months While adopting factors for determining examination frequency,[4] the Commissioner also amended the instructions for preparing the independent annual audit report in section 1741.5, to provide the Commissioner with assistance in determining if an escrow agent is in compliance with the Escrow Law and to expose risk factors that may warrant a regulatory examination more frequently than once every 48 months.

The changes to section 1741.5 were intended to mitigate the consumer risk associated with the expanded regulatory examination schedule under AB 459, and to provide the Commissioner additional information to determine the frequency of the routine regulatory examinations. In 2002, the changes to section 1741.5 were finalized and required that the audit reports contain additional information and that the auditor perform additional procedures during the audit. In particular, the requirements added to section 1741.5 in 2002 included the following:

- Require that the audit report include a schedule showing the computation of the licensee’s liquidity and tangible net worth for measuring compliance with Financial Code section 17210 and an itemized schedule listing each item included in the computation. Require certain information be included that is necessary to include marketable securities and fee receivables as liquid assets.

- Require that the audit report include copies of the trust bank reconciliations for each location as of the balance sheet date, including all interest bearing and dormant accounts and all outstanding checklists. The report must include an explanation for all adjustments appearing on the reconciliation, including an affirmative statement if any reconciling items were not adjusted as of the date of the balance sheet and

[4] Cal. Code Regs., tit. 10, § 1729.

whether or not any of the adjustments cause debit balances or shortages. The Department is required to maintain the outstanding checklists in the confidential section of the licensee's file. Require that the audit report include separate trial balances for transactions covered by Escrow Agents' Fidelity Corporation ("EAFC") and those requiring separate fidelity bonding.

- Require a statement in the audit report whether or not the escrow agent licensee maintains trust accounts and escrow trust records for those transactions covered by EAFC separate from the trust accounts and escrow trust records for those transactions not covered by EAFC.

- Require a statement in the audit report that the escrow agent licensee is in compliance with the fidelity bonding requirements.

- Require that the audit report include a full explanation of the resolution of all debit balances or a statement that the debit balances have not been resolved as of the auditor's report date.

- Require that the auditor perform procedures to determine the disposition of old dormant trust funds and old outstanding checks and include the results of the procedures in the audit report.

In early 2013, the Department identified that some annual reports submitted on behalf of licensees under section 1741.5 did not contain unqualified opinions regarding the procedures performed under section 1741.5 and section 17406 of the Escrow Law. In follow up correspondence, the Department was advised that the CPAs would be violating their professional standards to provide opinions on audit procedures defined by a third party.[5] The California Society of Certified Public Accountants ("CalCPA") advised the Department that an agreed-upon procedures report would be the appropriate way to obtain a report that is consistent with the regulation.[6]

On July 24, 2013, the Department met with interested parties to discuss potential ways to resolve the CPA compliance issue while still providing the Department with an annual report that is the result of an audit designed in part to identify potential risks of loss or mishandling of consumer funds. The parties sought a solution that would not result in increased costs or the need for multiple engagements. However, the inability of a CPA to provide an unqualified opinion with respect to procedures defined by a third party

---

[5] Patrick D. Felde, Certified Public Accountant, letter to Richard Malme, Specialist, Department of Corporations (now the Department of Business Oversight), May 7, 2013. In particular, Patrick D. Felde wrote, "A CPA license only gives one the ability to render an opinion and provide assurance on a set of financial statements and supplemental information that is related to the financial statements. The CPA professional standards do not allow a CPA to render an opinion or assurance on the safety or integrity of a trust account reconciliation or a set of procedures performed on the trust account reconciliation or trust accounting."

[6] Michael D. Feinstein, Chair, Accounting Principles & Auditing Standards Committee, California Society of Certified Public Accountants, letter to Jan Lynn Owen, Commissioner of Corporations (now Commissioner of Business Oversight), May 6, 2013.

hindered the Department's ability to have a single CPA engagement for all of the procedures under section 1741.5. Consequently, the proposed revisions to the rule require two engagements, with the opinion and findings of each engagement to cumulatively represent the annual report required by section 17406 of the Escrow Law.

In this regulatory action, the Department is proposing to amend existing section 1741.5 to achieve the same goals of the existing rule, through requirements and procedures intended not to conflict with a CPA's professional standards. The proposed rule requires a licensee to enter into two engagements with the CPA; one engagement for an audit of the licensee's financial records, and a second agreed-upon procedures engagement for a CPA to perform the additional procedures required by Department. The proposed rule clarifies that the Department is seeking a CPA's opinion only for the licensee's financial statements and supplementary information. As the Department has been advised by members of CalCPA,[7] a CPA must exercise independent professional judgment to establish the audit procedures for a financial audit, and the Department may not direct the procedures of an audit where the CPA is providing an opinion. For the additional procedures required by the rule, the rule requires the licensee to enter into an agreed-upon procedures engagement with the same CPA whereby the CPA is to issue a report of findings on the outcome of the procedures. In particular, the Department is seeking to propose amendments to section 1741.5 to do the following:

- Provide that through section 1741.5, the Department is seeking an independent audit of the licensee's financial statements with an opinion from a CPA on whether the statements are fairly stated;
- Provide that the supplementary information required by the rule is information that the licensee (or its accountant not responsible for the audit) should be preparing as a supplement to its financial statements;
- Provide that through section 1741.5, the Department is seeking an independent audit of the supplementary information with an opinion from the independent accountant on whether the supplementary information is fairly stated in relation to the financial statements as a whole, as contemplated by, AU-C Section 725 (American Institute of CPAs Professional Standards; AU-C Section 725: Supplementary Information in Relation to the Financial Statements as a Whole). AU-C Section 725 provides that the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole;
- Provide that through section 1741.5, the Department is seeking a report of findings with respect to the additional procedures to be performed by the CPA, as contemplated by an agreed-upon procedures engagement under AT Section 201 (Statements on Standards for Attestation Engagements; AT Section 201: Agreed Upon Procedures Engagements). AT Section 201 sets forth attestation standards

[7] CalCPA comment, Second Invitation for Comments (PRO13/13), September 2017.

and provides guidance to a practitioner concerning performance and reporting in agreed-upon procedures engagements; and

- Set forth procedures for the CPA to follow in the agreed-upon procedures engagement.

Through this rulemaking the Department seeks to achieve the benefit of ensuring that the engagements between the licensees and CPAs do not place the CPAs in a position of having to violate their professional standards. The procedures to be performed by the CPAs are intended to provide the equivalent public protection and compliance assurance as the existing rule, while avoiding the expense for licensees of a more frequent regulatory examination. In summary, the rulemaking would: (1) allow escrow companies to be in compliance with the Escrow Law; (2) allow the CPAs to comply with their professional standards; and (3) protect consumers.

Specific Purpose, Rationale and Benefit for Each Change

Section 1711.1

Section 1711.1 would clarify that "personal property" within the definition of "escrow" under Financial Code section 17003 includes "gametic material." Section 17003 defines "escrow" as any transaction in which one person, in order to sell, transfer, encumber, or lease real or personal property to another person, delivers a written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held until the happening of a specified event or the performance of a prescribed condition, at which time it is delivered to a grantee, grantor or its representative. The definition of "personal property" does not specify if it includes "gametic material." In 2010, Family Code section 7961, which requires a non-attorney surrogacy or donor facilitator to direct a client to deposit all client funds into either an escrow maintained by an independent escrow company or a trust maintained by an attorney, was enacted. A non-attorney surrogacy or donor facilitator is generally an individual or organization that facilitates surrogacy transactions, where a woman bears and carries a child for another through medically assisted reproduction, or facilitates egg donation transactions, where a woman provides her oocytes to assist another in having a child or children.[8] The requirement to use an attorney or escrow company to maintain the funds was enacted in response to the number of people providing funds to surrogacy or donor facilitators who subsequently disappeared with the money.[9] There has been

---

[8] Family Code section 7960 provides that a non-attorney surrogacy or donor facilitator is a non-attorney that (1) charges a fee for services relating to an assisted reproduction agreement or oocyte donation, or (2) advertises to solicit parties to an assisted reproduction agreement or for the donation of oocytes, or (3) acts as an intermediary between the parties to an assisted reproduction agreement or oocyte donation. Family Code section 7606 defines "assisted reproduction" as conception by means other than sexual intercourse, and defines "assisted reproduction agreement" as a written contract that includes a person who intends to be the legal parent of a child born through assisted reproduction, and defines the terms of the relationship between the parties to the contract.

[9] Assem. Com. on Judiciary, Analysis of Assem. Bill No. 2426 (2009-2010 Reg. Sess.) May 4, 2010; Sen. Com. on Judiciary, Analysis of Sen. Bill. No. 2426 (2009-2010 Reg. Sess.) Jun. 21, 2010.

uncertainty whether an escrow under Family Code section 7961 is an escrow within Financial Code section 17003. Currently, the companies that make such transactions have been found to be in violation of the Escrow Law provisions because they did not believe such transactions were covered under the Escrow Law. To address this issue, the rulemaking would clarify that because "gametic material" is included in the definition of "personal property," these transactions fall under the Escrow Law. This would clarify the Department's role in regulating such transactions and ensure the consumers receive the protection of the Escrow Law.

Section 1732.2, Subsection (a)(2)

Section 1732.2 sets forth what books an escrow agent is required to establish and maintain regarding its escrow accounts and specifies how often they must be reconciled. In particular, the existing rule requires an escrow agent to establish and maintain an escrow liability controlling account. Subsection (a)(2) of section 1732.2 currently contemplates non-electronic reconciliation, which does not involve the use of computer programs.

Many escrow agents currently establish and use computer programs to maintain books, accounts and records. The existing rule does not provide clarification regarding the use of computer programs. To address this shortcoming, the proposed amendment to the rule provides clarification for the use of accounting software. The amendment would require an escrow agent to maintain its escrow liability controlling account separately from any accounting software used by the escrow agent to record activity in its accounts. This is necessary to help escrow agents comply with the law when using software to keep their books. There are a few reasons why maintaining a controlling account separately from any accounting software is necessary: (1) The controlling account (also known as "manual control") is the basis to reconstruct ledgers when software crashes or a licensee ends its subscription to the software and loose access to electronic records kept in their software system; (2) A separate controlling account allows the licensee to identify discrepancies in book entries through the reconciliation of the ledgers to its controlling account. Licensees can make prompt corrections to erroneous entries to avoid trust shortage. This is essentially a check and balance system to ensure the accuracy of ledger entries.

The proposed amendment to require escrow agents to maintain their escrow liability controlling accounts separately from any accounting software they use to record activity in their accounts is beneficial to escrow agents because it provides them guidance on what the Department expects when they are using software to keep their books.

Section 1732.2, Subsection (a)(3)

Section 1732.2 sets forth what books an escrow agent must establish and maintain regarding its escrow accounts and specifies how often they must be reconciled. In particular, the existing rule includes a requirement that an escrow agent retain adding machine tapes, with reference to its escrow accounts, as specified. The existing rule,

which provides clarification regarding the use of adding machines, is no longer necessary because such machines are no longer widely used. Subsection (a)(3) of section 1732.2 currently contemplates non-electronic reconciliation, such as using adding machines, which is time consuming and does not involve software. Reconciling accounts using adding machines is more time consuming than reconciling them electronically and it does not involve the use of computer programs.

Many escrow agents currently use computer programs to electronically maintain books, accounts and records. As a result, these escrow agents perform their required reconciliations electronically as well. To address the outdated presumption that adding machines are still widely used, the proposed amendment to the rule would delete the language requiring the submission of adding machine tapes. This is necessary to provide licensees updated requirements regarding a cash receipt and disbursement journal and a file containing receipts, checks and check stubs. This will benefit the Commissioner by ensuring that licensees submit the correct supporting documentation and it will benefit licensees by deleting a requirement that is rarely used in the escrow industry.

Section 1732.2, Subsection (b)

Section 1732.2 sets forth what books an escrow agent must establish and maintain regarding its escrow accounts and specifies how often they must be reconciled. In particular, the existing rule specifies the escrow ledger and liability controlling account must be reconciled at least once a month with bank statements of the “trust” or “escrow” account, and the escrow ledger must be reconciled at least once a week with the escrow liability controlling account. Subsection (b) of section 1732.2 currently requires reconciliation of the escrow ledger and the escrow liability controlling account once a week. But due to modern technology, this process has been made much more expedient. Misappropriations, accidental or intentional, may occur on a daily basis. Increased reliance on computers by escrow companies has led to an ability to reconcile accounts more frequently. More frequent reconciliations will help escrow companies identify these issues faster. To address this issue, the proposed amendment to the rule would require such reconciliations to occur on a daily basis. This will benefit the public by enabling escrow agents to know sooner if there is something in the books that may indicate a possible trust account loss so they may address it in a timely manner.

Section 1737.3, Subsection (a)

Subsection (a) of section 1737.3 requires escrow agents to preserve records for at least five years from the close of escrow. The existing subsection (a) of Section 1737.3 implies that records can be destroyed after five years from the close of escrow. Some companies have reasonably understood this as authorizing the destruction of records after the time lapses. It does not take into account that there could be undisbursed funds in escrow or outstanding checks that need to be escheated. The State Controller’s Office requires files for escheated funds be kept for seven years. To address that issue, the amendment to the rule would take these requirements into account by requiring the licensee to keep the files for *at least* five years, or longer where necessary in order to

comply with other laws. This is necessary to ensure that undisbursed funds are escheated as required by law. This shifts the burden to the licensee to make sure records are preserved for as long as necessary in order to meet its legal obligations. This will benefit the public by ensuring that escheated funds may be claimed by them through the State Controller's Office.

Section 1737.3, Subsection (a)(2)

Subsection (a)(2) of section 1737.3 currently requires an escrow agent to preserve all canceled checks drawn upon the "trust" or "escrow" account for at least five years from the close of escrow. It is being amended to add that the licensee may preserve images of the front and back of the check in lieu of the original check. Most banks don't return original canceled checks to their clients. They scan the canceled checks and provide imaged canceled checks in the back of the bank statement to their clients. Banks provide imaged checks to reduce cost. If the Department's examiners don't have the physical canceled checks to review, they may review an imaged canceled check showing the front and back of the check so they can see the check information on the front and the endorsement on the back. Adding this language is necessary to ensure that escrow licensees are not found in violation of the Escrow Law for reasons beyond their control and are not caused undue hardship by being required to find a bank that is willing to return original canceled checks in lieu of providing imaged checks. This is beneficial to the public because it allows escrow companies to retain imaged canceled checks, which is cost-effective and avoids shifting a cost burden to consumers. It is also beneficial to the Department because its examiners can review imaged canceled checks electronically to improve examination efficiency. Examination efficiency also benefits the licensees as it may reduce exam costs.

Section 1737.3, subsection (b)

Subsection (b) of section 1737.3 currently allows an escrow agent to retain and provide the records referenced in subsection (a) to the Commissioner in an electronic format if the records are maintained and provided in a format that allows the Commissioner or his or her authorized representatives complete access to all of the books, accounts and records. The electronic records must be provided to the Commissioner in a software format that is acceptable to and possessed by the Commissioner. The escrow agent must ensure that the Commissioner has the ability to download and print any or all of the records that are stored and maintained electronically. Subsection (b) is being amended to add that electronic records transmitted by email must be sent using encryption or other secure manner. Encryption is necessary because most of the records sent by licensees contain confidential information about consumers and their escrow transactions. The confidential information may include a consumer's full name, social security number, driver license number, bank account information, etc. This language will enable licensees to provide confidential information to the Department in a secure manner to mitigate the risk of consumer information falling into the wrong hands. This is necessary because using email encryption or another secure process is an added

layer to protect consumers' private and confidential information. The change will benefit the public because it will add a layer of protection for consumers' private information. .

The subsection is also being amended to add that the escrow agent must provide all records maintained in electronic format in printed form if the electronic records are not in a format that enables the Commissioner to determine if the licensee is complying with the Escrow Law or rules, or upon the request of the Commissioner. When an escrow company changes its software, all or some of its past records may be lost or unavailable through the new software. If licensees keep hard copies of their records, or electronic (e.g. PDF) copies of their records downloaded from their software provider which can be readily made available to our examiners, the Department will be able access all of the licensees' records. The amendment to the rule would require the escrow agent to maintain printed copies of all records required to be maintained by this rule when an escrow agent changes its software and past records are no longer available electronically. This amendment is needed to ensure that all of a licensee's requisite records are available to the Commissioner at all times. This will benefit licensees, the Department and the public by ensuring that records are accessible should the company change accounting software and lose access to the documents created under the prior accounting software vendor.

Section 1737.3, Subsection (c)

Section 1737.3 does not currently define "statement of account." Escrow agents have requested that this term be defined in the escrow regulations. Subsection (c) of section 1737.3 would amend the existing rule to define "statement of account" to mean a report that identifies each receipt, disbursement, and credit of escrow funds for an escrow transaction. This definition is consistent with the description contained in section 1741.3 and is necessary to distinguish the closing statement (statement of account) from the escrow ledger. This definition is beneficial because it clarifies the difference between a closing statement given to principals of the transaction at the close of the escrow and the escrow ledger. If not clearly defined, the term will cause confusion among some lenders. Lenders typically require escrow agents to provide a copy of the final closing statement as a condition of funding a loan. But some lenders also request that escrow agents provide a copy of their escrow ledger which contains disbursement information not privy to the lender. A clear definition will help to distinguish which party receives each document in the transaction.

Section 1741.5

Section 1741.5's existing title refers to "audit" reports. Having the word "audit" in the title implies an opinion should be issued by a CPA. The problem is, CPAs cannot render an opinion on agreed-upon procedures because doing so would violate the American Institute of CPAs' Professional Standards. CPAs can report the agreed-upon procedures and their findings in a separate report. To avoid the implication that the report must be prepared by a CPA, it is necessary to change the title of the report to "Annual Report" and clarify that the report includes an audited financial report and a report of findings from performing agreed-upon procedures.

Additionally, the Department is repealing the related Audit Instructions. CPAs cannot issue opinions on agreed-upon procedures because performance of these procedures would be a violation of CPAs' professional standards, which prohibit them from issuing an opinion for procedures that are not part of the financial audit. Thus, CPAs refused to perform the procedures under the existing section, titled "Preparation of Independent Audit Report." It is necessary to rewrite this section to provide clarification to CPAs and enable them to perform procedures without violating their professional standards.

Section 1741.5, Subsection (a)(1)

Subsection (a)(1) of section 1741.5 sets forth definitions that apply to that section, which relates to the preparation of the annual audit report. Financial Code section 17406 requires that the annual report be submitted to the Commissioner within 105 days of an escrow agent's chosen fiscal year end. Interested parties have suggested to the Department that terms and phrases from the existing section require definitions. It is necessary to define the terms that will be used to prepare the submission of the annual audit report. The definitions will make it easier for the licensee's CPAs to comply with the annual audit report requirements. The definitions will help ensure that the terms in the Agreed Upon Engagements are interpreted consistently by the CPAs doing the reports so they apply the same definitions to the procedures. These terms are commonly understood by escrow companies and CPAs.

The added definitions will help ensure that the reports are complete, consistent and submitted in a timely manner. Specifically, the definitions regarding "reconciling" are explained below.

Subsection (a)(1)(M) of section 1741.5 defines reconciling items that need to be adjusted to the book balance. This definition is necessary to clarify the Department's expectation for the scope of identifying book adjustment items in the agreed-upon procedure. It also provides guidance on how reconciling items on the book side should be described. It helps clarify the scope of book adjustment review for CPAs. It benefits the CPA by providing clear guidance and benefits the Department by minimizing the inquiries from CPAs seeking clarification about book adjustments.

Subsection (a)(1)(N) of section 1741.5 defines reconciling items that need to be adjusted to the bank balance. This definition is necessary to clarify the Department's expectation on the scope of identifying bank adjustment items in the agreed-upon procedure. It also provides guidance on how reconciling items on the bank side should be described. It helps to clarify the scope of bank adjustment review for CPAs. It benefits the CPA by providing clear guidance and benefits the Department by minimizing the inquiries from CPAs seeking clarification about bank adjustments

Subsection (a)(1)(O) of section 1741.5 defines reconciling items that cause debit balances and/or trust account shortages. This definition describes examples of typical scenarios where a debit balance or trust account shortage will occur. It is necessary to provide examples for CPAs to detect debit balances and trust account shortages so they

can promptly identify those for licensees and enable the Department to take corrective actions. The definition benefits consumers, licensees and the Department by helping ensure that trust account shortages or debit balances are properly identified and timely corrected.

Subsection (a)(1)(P) of section 1741.5 defines source documents. This definition describes sample source documents that are necessary to support the explanation and corrections for items that require reconciliation. It is necessary to have source documents to support items that require reconciliation because the documents provide a basis for the Department's factual findings, which it can use to require a licensee to cure a shortage.

Section 1741.5, Subsection (a)(2)

Subsection (a)(2) of section 1741.5 sets forth the requirements for a written engagement. The existing rule sets forth procedures for a CPA to follow in the annual audit of the licensee, which if accompanied by an unqualified opinion would result in the CPA violating the professional accounting principles. In particular, the provisions of Rule 1741.5 that dictate the procedures for a CPA to follow may only be performed under an agreed-upon procedures engagement in accordance with national attestation engagement standards, applicable to certified public accountants, and may result in findings regarding the procedures performed. However, the CPA may not provide an unqualified opinion on audit procedures not established under the CPA's own professional judgment.

To avoid violating the professional accounting principles, CPAs have been refusing to draft the annual audit reports as required by the Escrow Law. As a result, many escrow agents are out of compliance with the requirement for submitting a proper annual audit report and may be subject to license suspension or revocation. Additionally, without the audit reports, the Commissioner cannot validate the financial health of the escrow companies. The proposed rule would provide the guidance needed to enable CPAs to prepare the required audit reports without simultaneously violating their professional standards of conduct.

The proposed written engagement is an agreement between the CPA and the escrow company describing what the annual report will include, the procedures the CPA will use to prepare the report, and the cost to prepare it. The annual report must be prepared by the same practitioner, a CPA, to ensure that the information in the annual report is accurate, consistent and unbiased. The engagement must include the licensee's direction to report the specified information directly to the Commissioner to ensure it is accurate and unbiased. The rule is necessary to provide guidance to the CPAs and make the licensee responsible for the CPA's compliance because the Commissioner does not have regulatory authority over the CPAs so he or she cannot require a CPA to comply with the rule. These requirements will protect public safety by ensuring that the annual report includes accurate and consistent information so that the Commissioner may expediently address any trust fund issues.

Section 1741.5, Subsection (a)(2)(A)

Subsection (a)(2)(A) of section 1741.5 is being added to require a licensee to direct its CPA to report information relating to checks and the account balance of every trust account to the Department without additional notification of or consent from the licensee. Currently, subdivision (l) (1)-(4) of Financial Code section 17406 allows a CPA to immediately report a debit balance, an unreconciled trust account over two months, and uncorrected reconciling items for more than two months to the Department. It does not address any unauthorized disbursement of trust funds, check kiting, etc. disclosed by CPAs during their audit. Adding this language will enable CPAs to report anomalies directly to the Department so it can take prompt actions to investigate and protect consumers' funds. Currently, CPAs report employee embezzlements and other anomalies not covered by the reporting requirements in Financial Code section 17406 to the management of escrow companies. Adding the requirement to report these problems *directly* to the Department, without first notifying the licensee, will allow the Department to more quickly respond to CPA notifications, investigate shortages, embezzlement, and kiting, and work with licensees to replace shortages in consumers' funds. This benefits consumers, the Department and escrow companies by resolving trust account issues before they lead to consumer losses or financially unhealthy companies.

Section 1741.5, Subsection (a)(2)(B)

Subsection (A)(2)(B) of section 1741.5 is being added to require a licensee to be responsible for its CPA's compliance with the requirements for preparing and submitting its annual report within 105 days after the close of the licensee's fiscal year end. The 105-day deadline is based on existing Financial Code section 17406. The 105-day deadline provides a reasonable amount of time for an escrow company and its CPA to work together to clear trust reconciling items and make corrections to cure financial deficiencies before its CPA submits the report to the Department. CPAs include updates up until the report issuance date in a note on the report for subsequent events. For example, if a company fiscal year ends on December 31, the submission deadline will be April 15. If a CPA identifies a licensee's financial deficiencies in January, the licensee will have an opportunity to promptly correct its financial deficiencies in February. Once the financial deficiencies are corrected, CPAs will have to wait until around mid-March for the licensee to close its books for February and complete its general account bank reconciliation before the financial compliance can be shown on the February financial statements. If a licensee cannot cure its financial deficiencies in February, it can still make capital contributions in March, so the March financial statement will reflect the correction for financial deficiencies. Once the March financials are available in April, a CPA can complete the report and submit it to the Department.

Section 1741.5, Subsection (b)(1)

Subsection (b)(1) of section 1741.5 sets forth the requirements for audited financial statements. The rule requires a licensee to engage a CPA to provide the statements, in which the CPA must opine to the Commissioner on whether they fairly represent the

licensee's financial position, results of operations and cash flows. The audit of the financial statements and supplementary information required by the existing rule must be submitted with an opinion from an independent CPA or independent public accountant on the fairness of the statements and supplementary information, whereas the additional audit procedures required by the existing rule must be submitted with a report of findings on the procedures. The changes to the rule are intended to ensure that the attestations required as part of the annual audit report are consistent with the professional standards for independent public accountants. Currently, CPAs are unable to submit audit reports which comply with the procedures required by section 1741.5 as currently written without violating their rules because they are not consistent with the American Institute of Certified Public Accountants rules for CPAs expressing opinions on nonfinancial statement audits. As a result, many escrow agents are out of compliance with the requirement for submitting a complete annual audit report and may be subject to license suspension or revocation. Additionally, without the complete audit reports, the Commissioner cannot validate the financial health of the escrow companies. This change is necessary to make the additional procedures consistent with American Institute of Certified Public Accountants ("AICPA") rules, which will enable CPAs to comply with the AICPA rules in providing the information required by the Department. This will protect the public by requiring all CPAs to apply the same procedures so that the Department will receive more complete, consistent reports to better assess the condition of the escrow companies.

Section 1741.5, Subsection (b)(2)

Subsection (b)(2) of section 1741.5 is being added to clarify what information must be contained in the audited financial statements, including notes to the financial statements, officer, director or shareholder compensation, long term notes or mortgages and a schedule of securities. The existing rule requires a licensee to include the following information in the audited financial statements that it submits to the Commissioner: a statement regarding the trust account, information regarding any other business it is engaged in, an income statement with salaries and bonuses paid to officers, liabilities, including long term notes or mortgages, and a schedule of all securities. The existing rule does not clearly define information that must be included and procedures that need to be performed in order for a CPA to compile the annual report. The amendment to the rule would provide further clarification regarding this information. The clarifications are necessary to ensure that the licensees provide consistent information to the Commissioner. The consistent information will help the Commissioner to better assess the condition of the escrow companies.

Section 1741.5, Subsection (b)(2)(A)

Subsection (b)(2)(A) of section 1741.5 requires a CPA to report net reconciled balances, assure trust funds are not assets of the company, and state whether trust funds are adequately covered by any fidelity policy. These requirements provide guidance and clarification for CPAs to compile their reports. These requirements are necessary for the CPAs to report information to the Department so it can assess the risk and integrity of trust accounts. This benefits CPAs because clear guidance helps CPAs to compile

complete reports. It also benefits the Department by ensuring the Department receives complete reports with which to assess a company's books, records and accounts. Having complete reports to review enables the Department to detect and resolve issues more quickly to help protect consumer funds.

Section 1741.5, Subsection (b)(2)(B)

Subsection (b)(2)(B) of section 1741.5 requires a CPA to report officer, director or shareholder compensation to the Department. This information is necessary for the Department to identify a company's pattern of expenditure on management's compensation. It also helps the Department to assess management risk. If a company's shareholder is well-compensated but the company is poorly capitalized to meet financial requirements, the shareholder's compensation reflects a risk that the company's finances are not properly managed. This requirement is necessary to provide the Department information needed to assess management risk and take proper actions to mitigate the risk. Identifying such risk and taking corrective actions benefits the Department, the company and the public by helping companies be financially healthy and avoiding losses of consumer funds.

Section 1741.5, Subsection (b)(2)(C)

Subsection (b)(2)(C) of section 1741.5 requires a CPA to report long-term notes or mortgages. It provides guidance for CPAs to report observation for these liabilities. It requires CPAs to review substantiation for long term liabilities before they classify them on the balance sheet. It prevents CPAs from classifying a note or mortgage as long-term based solely on information received from the management of a company. Long-term liability does not affect a company's ability to meet the liquid asset requirement. Therefore, it is necessary that CPAs validate management's claim of a long-term liability with substantiating information before they perform the calculation for a company's net liquid asset. This requirement benefits CPAs and the Department by ensuring long-term assets are properly classified on the balance sheet and that the net liquid asset calculation is properly performed.

Section 1741.5, Subsection (b)(2)(D)

Subsection (b)(2)(D) of section 1741.5 requires CPAs to review substantiation information for marketable securities, which a licensee may classify as its liquid asset and attribute it as such in its liquid asset compliance calculation. The purpose of requiring substantiation for marketable securities is to ensure proper accounting treatment of these assets. This section benefits CPAs by providing clarification and guidance for them to compile their reports.

Section 1741.5, Subsection (c)(1)

Subsection (c)(1) of section 1741.5 sets forth what must be included in the agreed-upon procedures engagement. The rule requires a licensee to engage a CPA to perform

specific procedures, described in subsections (A)-(F), and directly submit a report of findings in the annual report to the Commissioner. Each provision explains the role and responsibilities of parties to the agreed-upon procedures engagement so that the performance required of the engagement is in accordance with national attestation engagement standards applicable to certified public accountants.

Financial Code section 17406 requires a licensee to submit to the Commissioner, at its own expense, an audit report containing audited financial statements covering the calendar year or, if the licensee has an established fiscal year, then for that fiscal year, within 105 days after the close of the calendar or fiscal year. It requires that the reports and financial statements must include a balance sheet and a statement of income for the year ended on the balance sheet date together with other Commissioner required relevant information. It further requires that the reports and financial statements be prepared in accordance with generally accepted accounting principles and accompanied by a report, certificate, or opinion of, an independent CPA or independent public accountant. Additionally, it requires that the audits be conducted in accordance with generally accepted auditing standards and the rules of the Commissioner. Lastly, it requires each licensee to file additional relevant information as required by the Commissioner.

"Agreed-upon procedures" is an AICPA term that specifies the type of engagement that will take place between the licensee and its CPA. This amendment to the rule explains the purpose and responsibilities under an agreed-upon procedures engagement. It provides the authority for use of the procedures and the expectations of the Department, the licensee and the CPA. It places responsibility for the records on the licensee, the sufficiency of the procedures on the Department and the reporting of the results of the procedures on the CPA. This is necessary to ensure there is an agreement between the CPA and the escrow company describing what the annual report will include and establish the roles and responsibilities and procedures to be performed in the preparation of the report. This change is needed to ensure the annual audit report contains consistent information when it is submitted to the Commissioner. The Department, the licensee and the CPA benefit because the roles and responsibilities of each are clearly stated.

Section 1741.5, Subsection (c)(1)(A)(i)

Subsection (c)(1)(A)(i) of section 1741.5 would require that the CPAs perform agreed-upon procedures engagement in accordance with national attestation engagement standards applicable to certified public accountants when completing the annual report. The AICPA represents the CPA profession nationally regarding rule-making and standard-setting, and serves as an advocate before legislative bodies, public interest groups and other professional organizations.

The AICPA also develops standards for audits of private companies and other services by CPAs; provides educational guidance materials to its members; develops and grades the Uniform CPA Examination; and monitors and enforces compliance with the profession's technical and ethical standards. If the CPAs do not comply with the requirements and guidance of the AICPA, their licenses may not be in good standing, which will impact their ability to submit reports to the Department. Absent the reports, the

Commissioner would not be able to assess the companies' compliance with the Escrow Law. These amendments are necessary to inform the licensees and CPAs the requirements and guidance with which they must comply to properly prepare the annual report required by the Commissioner. The amendment will help ensure that the annual reports are prepared consistently so that the Commissioner may better assess the condition of the escrow companies.

Section 1741.5, Subsection (c)(1)(A)(ii)

Subsection (c)(1)(A)(ii) of section 1741.5 requires CPAs to identify each of the procedures required and provide the findings derived from each procedure. This requirement is necessary to ensure all procedures are performed before the compilation of the annual report. Any missing procedures will not only incur additional costs for licensees to have the missing procedures performed but also affect the Department's ability to timely review the report and work to resolve issues, if any, identified by the report with licensees. This requirement will benefit the Department and licensees by helping to ensure that any issues are identified in the report so that they may be resolved efficiently.

Section 1741.5, Subsection (c)(1)(B)

Subsection (c)(1)(B) of section 1741.5 includes and renumbers a portion of existing section 1741.5 subdivision (a)(2)(F). The other portion, which explained what a trust accounting was, is being included in section 1741.5 subsections (c)(1) and (c)(3). This subsection, as amended, would set forth the procedures related to trust accounting and the report of findings to indicate that the procedures were performed on the trust accounting records of all the locations of the licensee. It is necessary to keep this requirement in the audit procedures to ensure that the CPAs perform procedures for all locations, which is consistent with the existing rule. This change will ensure that CPAs perform the audit procedures on all locations so that all locations will be included in the annual report.

Section 1741.5, Subsection (c)(1)(C)

Subsection (c)(1)(C) of section 1741.5 would make the Commissioner the specified party of each engagement entered into and serve as an acknowledgement by the Commissioner that the procedures included in the rule are sufficient. This is necessary to ensure agreed-upon procedures are performed in accordance with national attestation engagement standards, which include a CPA's responsibilities, performance standards, and reporting criteria. Agreed-upon procedures require a specified party to acknowledge the procedures; this rule would provide that the Department serves as the specified party.

The amendment will help ensure that the annual reports are prepared consistently so that the Commissioner can assess the condition of the companies.

Section 1741.5, Subsection (c)(1)(D)

Subsection (c)(1)(D) of section 1741.5 would provide a representation by the Commissioner that all matters set forth in the national attestation engagement standards applicable to CPAs and this rule, constitute the letter to the CPA. This requirement is asking both the Department and licensees to provide an engagement letter to a CPA for performing agreed-upon procedures This is necessary for the Department to acknowledge its roles and responsibilities as an engaging party for agreed upon procedure engagements. It is a blanket statement that satisfies a requirement for an engaging party in the accounting standard. The purpose of the rule is to enable practitioners to perform the agreed upon procedures without violating their professional standards. If the Department does not provide this statement, a practitioner may use it as grounds to reject an engagement and not do an audit. The rule would fulfill the Department's obligation to provide the practitioner a letter under the accounting rule so that a practitioner may do an audit. Without this statement, the Department would have to provide a written representation letter for every single engagement.

This language is also necessary for CPAs to establish that the procedures they perform are in accordance with the Department's requirements. In order for agreed-upon procedures to be performed by a CPA, all representations need to be clearly defined. This statement would provide CPAs assurance that their procedures will meet the Department's requirements. Licensees are also required to provide a written representation to their respective CPAs, under national attestation engagement standards applicable to CPAs.

This would help licensees comply with the requirement to submit the annual report by providing CPAs the guidance they require to complete licensees' annual reports.

Section 1741.5, Subsection (c)(1)(E)

Subsection (c)(1)(E) of section 1741.5 would require licensees to make representations, including being responsible for the contents of their books and records and assertions regarding their records and business activities, providing the CPA with access to all their relevant records, disclosing all matters deemed appropriate by the CPA, the specified levels of the minimum net worth and the liquid assets, the timely escheatment of dormant escrow funds, the appropriate documentation and authorization for each accounting entry, their membership with the EAFC and fidelity bond coverage, if needed, and the appropriate reconciliation of all trust accounts. This is necessary to enable the CPAs to compare the results of their testing to the assertions of the licensee.

This is also necessary to clarify the licensee's responsibilities in the agreed-upon procedure engagement, and to ensure licensees provide their CPA complete access to books and records by making licensees acknowledge their responsibilities in the engagement. Without these assertions of the licensees, CPAs will still be able to compare the results of their review with what was presented to them from the licensees. However, requiring licensees to make these assertions will clarify their roles and responsibilities and encourage licensees to collaboratively work with their CPAs during the audit. This will ensure that the Commissioner will receive consistent reports, to better assess the financial condition of the companies.

Section 1741.5, Subsection (c)(1)(F)

Subsection (c)(1)(F) of section 1741.5 would clarify that the CPA's report of findings under the engagement is only for the Commissioner's use and constitutes a public record. This is necessary to establish that the report, except where noted otherwise, will be contained in the public files of the Department. The change will benefit the public by, except where otherwise noted, making the report available for public inspection.

Section 1741.5, Subsection (c)(2)

Subsection (c)(2) of section 1741.5 would require the CPA audit of a licensee's financial statements to confirm whether the licensee is in compliance with the minimum tangible net worth and liquid assets required by Financial Code section 17210 as of the balance sheet date. Section (C)(2)(A) would require that the audit include a schedule that shows the computation of the licensee's net liquid assets and tangible net worth as of the balance sheet date. Section (C)(2)(B) would require the audit to include an itemized schedule that lists each balance sheet item included in the computations. These requirements are included in existing rule (a)(2)(E). They were separated and renumbered in this proposed rule to make it consistent with the other proposed revisions to existing rule section 1741.5. This change will continue to ensure the calculations regarding the financial requirements are contained in the report so that the Commissioner can assess the condition of the companies.

Section 1741.5, Subsection (c)(3)(A)

Subsection (c)(3)(A) of section 1741.5 would require the CPA to inspect escrow balances, as of the balance sheet date, on the escrow trial balance and on the list of outstanding checks, and make a determination whether the licensee is timely escheating dormant escrow funds that have been outstanding for more than three years or such other time as required by law, as specified by Code of Civil Procedure section 1500 et seq. This is necessary for the Department to determine whether the company is properly escheating dormant funds to the State Controller's Office. It benefits consumers by ensuring that funds that are owed to them can be retrieved by contacting the State Controller's Office.

Section 1741.5, Subsection (c)(3)(B)

Subsection (c)(3)(B) of section 1741.5 would require the CPA to review the bank statement to inspect up to three current-year disbursals of funds from all escrow trust accounts that, prior to the current fiscal year, had a dormant account balance, and review the corresponding escrow files to confirm that none of the following conditions exist: (1) the disbursal of funds was not in accordance with escrow instructions; (2) the supporting documentation contains a misstatement or omits a material fact necessary to establish that the disbursal was authorized; or (3) the account entry lacks supporting documentation or documentation from the escrow file has one of more characteristics that suggest possible theft or fraud. Currently, it is difficult for the Department to verify whether escrow companies are properly safeguarding dormant funds. This is necessary for the

Department to determine that dormant funds are being disbursed properly. This benefits consumers who are rightly due the dormant funds and the Department by determining whether the company is properly safeguarding the dormant funds it holds.

Since dormant accounts typically do not have a lot of activity, requiring a CPA to select all current-year disbursements of funds, if there are less than three disbursements, or three current-year disbursements, if there are more than three disbursements total, will provide a CPA an adequate sample size to perform this procedure. For the dormant accounts with moderate activity, a sample of three may identify a reportable pattern of unauthorized disbursements, which may be investigated by the Department. This procedure and the procedure in subsection (c)(3)(C) of section 1741.5 collectively require CPAs to review a sample size of more than five percent of dormant files. Requiring the review of a minimum of five percent of dormant escrow files will cover an acceptable audit risk specific to the review of dormant files in identifying any unauthorized disbursements or misappropriations of dormant trust funds. If the review of sampling dormant escrow files yields results that include mishandling of dormant trust funds, upon receiving and reviewing the CPA's report, the Department will conduct an investigation.

Section 1741.5, Subsection (c)(3)(C)

Subsection (c)(3)(C) of section 1741.5 would require the CPA to select three escrows or five percent, whichever is greater, of the escrow balances that have a last activity date older than six months from the previous fiscal year-end date and that are no longer on the escrow trial balance, or from balances that have declined at current fiscal year end, from the escrow trial balance at the previous fiscal year-end date. For the selected escrows, it would require an inspection of escrow ledgers, escrow instructions, canceled checks, and any other supporting documentation to confirm that the reason for the removal of the escrow balance from the trial balance, or the reason for the decrease of the escrow balance on the trial balance, is one of the following: (1) the funds no longer reported in the escrow balance were disbursed according to signed escrow instructions or according to the instructions of a court of competent jurisdiction; or (2) the supporting documentation does not contain one or more characteristics that suggests possible theft or fraud; (3) the funds no longer reported in the escrow balance were interpleaded to a court of competent jurisdiction; or (4) the funds no longer reported in the escrow balance were escheated to the state.

The Department proposes these criteria: (1) to clarify how many dormant accounts have to be reviewed; (2) to limit the cost to the licensee; (3) to ensure that all of the CPAs are following the same criteria; and (4) to ensure that the Department receives an informative sample.

Dormant funds are most vulnerable to embezzlement because often times consumers do not know they have remaining funds in escrow unless a licensee contacts them. By manipulating records, an escrow employee may easily disburse dormant funds to themselves or their relatives or even pay their own bills. Most embezzlement cases are relating to dormant funds. This rule is necessary for the Department to determine that dormant funds are being disbursed properly. This benefits consumers who are rightly

due the dormant funds and the Department by determining whether the company is properly safeguarding the dormant funds it holds.

Since dormant accounts typically do not have a lot of activity, allowing a CPA to select “three escrows or five percent” of escrows will provide a CPA a feasible minimum sample size to perform this procedure. Where there is little activity, a sample of three may identify a reportable pattern of unauthorized disbursements. Requiring the review of a minimum of five percent of dormant escrow files will cover an acceptable audit risk specific to the review of dormant files in identifying any unauthorized disbursements or misappropriations of dormant trust funds. If the review of sampling dormant escrow files yields results that include mishandling of dormant trust funds, upon receiving and reviewing the CPA’s report, the Department may conduct an investigation. This procedure provides a parameter for CPAs to sample files that may identify a pattern of embezzlement.

Section 1741.5, Subsection (c)(3)(D)

Subsection (c)(3)(D) of section 1741.5 would require the CPA to select no less than five percent or all if fewer than five, of the checks that have a date older than six months from the previous fiscal year-end date and that are no longer on the outstanding check list at current fiscal year-end, from the list of outstanding checks at the previous fiscal year-end date. For the selected checks, it would require an inspection of the underlying escrow ledgers, escrow instructions, canceled checks, and check endorsements to confirm that the dormant outstanding checks no longer appearing on the list of outstanding checks (1) were paid in accordance with the signed escrow instructions, (2) were canceled back into the escrow funds and are accounted for on the escrow ledger, (3) were canceled and re-issued to the original payee, (4) were canceled and re-issued to a new payee according to instructions, or (5) were escheated to the state. If the checks were canceled, the audit must confirm that documentation exists to support that the cancellation is authorized. The Department proposed the criteria: (1) to clarify how many checks have to be reviewed; (2) to limit the cost to the licensee; (3) to ensure that all of the CPAs are following the same criteria; and (4) to ensure that the Department receives an informative sample. Dormant funds are vulnerable to be misappropriated because consumers do not always know there are remaining funds in their escrow account due to a title refund or other refund from overpayments. By manipulating records, escrow employees may easily disburse dormant funds to themselves or their relatives or even pay their own bills. Most embezzlement cases are relating to dormant funds. This rule is necessary for the Department to determine that dormant funds are being disbursed properly. This benefits both consumers who are due the dormant funds and the Department by determining whether the company is properly managing the dormant funds it holds.

Since dormant accounts typically do not have a lot of activity, allowing CPAs to select “5% or all if fewer than five” checks provides a sample size that will cover the review of dormant trust checks with an acceptable audit risk specific to this procedure to identify mishandling of dormant trust funds. If the review of dormant outstanding checks concludes there was a mishandling of funds, upon receiving and reviewing the CPA’s report, the Department may conduct an investigation.

Section 1741.5, Subsection (c)(4)

Subsection (c)(4) of section 1741.5 would require the CPA to perform the following procedures on at least two percent of, but not fewer than three escrows per licensed location at the fiscal year-end that were consummated and closed within the current fiscal year to verify the existence of authorization for disbursements: (1) Inspect the underlying documentation for each disbursement to confirm that the disbursement was authorized; and (2) Confirm that the underlying documentation supports a finding that each disbursement was authorized. The proposed rule would require that at least half of the escrows sampled must be escrows consummated and closed within 60 days prior to the selection of the sampling, unless an insufficient number of escrows were consummated and closed during this time period. If the underlying documentation does not confirm that every disbursement was authorized, document management's explanation for the disbursement and resolution, or, if no explanation is provided, indicate such in the report.

The Department proposes these criteria: (1) to clarify how many escrows have to be reviewed; (2) to limit the cost to the licensee; (3) to ensure that all of the CPAs are following the same criteria; and (4) to ensure that the Department receives an informative sample. This is necessary to confirm that the licensee is closing its escrows properly. This benefits the Department by determining whether the company should be placed on a shorter examination schedule if discrepancies are noted by the CPA. This also benefits consumers because if the CPA notes discrepancies, faster action can be taken by the Department against the licensee to prevent further harm to consumers.

Allowing a CPA to review "at least two percent of, but not fewer than three" escrows provides an adequate sample size to perform this procedure. This procedure is more comprehensive as it covers various aspects of escrow activities compared to the dormant file and dormant check review procedures. Therefore, a smaller sample size is sufficient to provide a view of a company's operations and compliance with the Escrow Law. This procedure includes, but is not limited to, the review of receipts, checks, disbursements, disclosures, recordings, escrow instructions and correspondence.

This procedure requires that "at least half of the escrows sampled must be escrows consummated and closed within 60 days prior to the selection of the sampling, unless an insufficient number of escrows were consummated and closed during his time period." This is a modification of the current procedure that requires a CPA to select file samples consummated and closed within 60 days of review. Expanding the period for which a CPA may select samples will enable CPAs to choose a sample pool that is inclusive throughout the fiscal year.

Section 1741.5, Subsection (c)(5)

Subsection (c)(5) of section 1741.5 would require the CPA to inspect the trust accounting records to determine whether the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c) (which are covered by EAFC), and whether the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified in the section (which are not covered by EAFC but are

instead covered by specified bonds), or both. Subsections (c)(5)(A) – (E) are necessary to ensure licensees maintain separate books, records, and accounts for different types of escrows and also maintain adequate bond coverage, which is typically renewed annually. The required amount for bond coverage may increase or decrease depending on the monthly average liability amount. Failure to cure bond deficiency may subject licensees to summary revocation. Requiring CPAs to review bond issues will give licensees the opportunity to quickly address bond deficiencies, if any, and also file any appropriate riders to the Department in order to remain in compliance with the Escrow Law.

Section 1741.5, Subsection (c)(5)(A)

Subsection (c)(5)(A) of section 1741.5 would require the CPA to ask the escrow manager to state the types of escrows being processed by the licensee. This language provides clarification for a CPA to obtain information from a licensee in order to define the scope of review. It is necessary because the CPA needs to obtain this information in order to determine whether a licensee needs to maintain separate books, records and accounts. This information is also necessary to review a licensee's compliance with bond and EAFC membership requirements. This requirement will benefit CPAs by providing clear guidance and benefit the Department by providing it information necessary to review a licensee's compliance with multiple requirements under the Escrow Law.

Section 1741.5, Subsection (c)(5)(B)

Subsection (c)(5)(B) of section 1741.5 would require the CPA to ask the licensee's management whether the licensee is engaging in business activities other than escrow services. This language provides clarification for a CPA to obtain information from a licensee to review the licensee's business practices. This is necessary because by reviewing whether an escrow company is engaging in business activities other than escrow services, a CPA will be able to have a better understanding of the company's financial wellness and whether any gain or loss from those other activities, permitted by the company's article of incorporation or not, has an effect on the company's compliance with liquid and tangible net worth requirements. This benefits CPAs by providing them a better view of the licensee's financial status and helping them understand the risk that may affect the licensee's financial compliance requirements. It also benefits the Department to have information to assess the risk associated with other business(es) and to determine how those other business activities affect the licensee and its handling of consumer funds.

Section 1741.5, Subsection (c)(5)(C)

Subsection (c)(5)(C) of section 1741.5 would require the CPA to confirm, in the case that the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c), as well as those not specified in the section, that the escrow books and trust accounts for those transactions specified in Financial Code section 17312, subdivision (c), are maintained separately from those transactions not specified in the section. This language provides clarification for a CPA to understand the requirement for separate books and records for different types of escrow transactions. It is necessary to

clarify types of transactions that should be maintained in separate set of books, records and accounts in order for a CPA to adequately assess the condition of a licensee's books and records and apply audit procedures to those separate sets of books and records. This provides clear guidance to CPAs.

Section 1741.5, Subsection (c)(5)(D)

Subsection (c)(5)(D) of section 1741.5 would require the CPA to, in the case that the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified in Financial Code section 17312, subdivision (c), confirm with the licensee's insurance carrier that the licensee maintains sufficient fidelity bond coverage as required by section 1723 of these rules. This language clarifies the procedure for a CPA to review a licensee's fidelity bond compliance. It is necessary to clarify this procedure for a CPA because the procedure is important to ensure a licensee has adequate insurance coverage for consumer funds in the trust account. It benefits consumers to have assurance that their funds, which are maintained by the licensee, are adequately insured. The subsection also requires the CPA to include the insurance information in the report of findings. This language clarifies that the necessary information must be included to support findings from the above procedure. This requirement is necessary to obtain information about a licensee's insurance to validate their self-reported insurance information on the annual liability report, and to resolve any discrepancy between insurance information filed with the Department and the most current up-to-date insurance information. It benefits the Department to have a licensee's most current insurance information to review for compliance.

Section 1741.5, Subsection (c)(5)(E)

Subsection (c)(5)(E) of section 1741.5 would require the CPA to confirm, in the case that the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c), that the licensee is a member of the EAFC in good standing. This language clarifies the procedure for a CPA to confirm a licensee's compliance with the EAFC membership requirement. This procedure is necessary because failure to comply with the EAFC membership requirement will pose a great risk to consumer funds that should have been, but are not, covered for loss by EAFC. Should a misappropriation of trust funds occur, a claim for loss could not be filed with EAFC and consumers will suffer a financial harm. Should a misappropriation of trust funds occur, consumers will not be able to file a claim for loss with EAFC and will suffer a financial harm. It benefits the consumers to ensure a licensee is in good standing with EAFC and that the trust funds maintained are covered for loss by EAFC.

If escrow transactions are not covered by EAFC or separate bonding, such uncovered transactions may result in losses that cannot be cured. These inquiries are for insurance purposes. If a licensee is not in good standing with the EAFC, (e.g., its membership is revoked), it has to purchase a separate individual fidelity bond policy, which will be much costlier in order to be in compliance. Therefore, these inquiries are necessary to determine whether the licensee is properly separating the transactions that are not covered by EAFC, which could leave some transactions without bond coverage.

This benefits the Department by determining compliance with the bonding statutes and consumers by ensuring that their transactions are covered by a bond.

Section 1741.5, Subsection (c)(6)(A)

Subsection (c)(6)(A) of section 1741.5 would require the CPA to include a month-end escrow liability list for the 12 months of the fiscal year in the report of findings and confirm that the amounts on the schedule agree to the adjusted book balances on the monthly trust account bank reconciliations for escrows that are covered by the EAFC, and a separate list of transactions not covered by the EAFC, if any. This is necessary for the Department to determine whether the company has adequate bonding and no overall liability overdrafts. . This also enables the Department to check for compliance with other bonding statutes and regulations When the Department's examiners review audit reports, they calculate surety bond requirements pursuant to Financial Code section 17202 for EAFC covered transactions and refer bond deficiencies to a specialist for further review and handling. Examiners also calculate fidelity bond requirements pursuant to California Code of Regulations, title 10, section 1723 for transactions not covered by EAFC, and refer fidelity bond and/or fidelity bond deductible deficiencies to a specialist for further review and handling. This benefits the Department in determining compliance with the bonding requirements, in Financial Code section 17202 and California Code of Regulations, title 10, section 1723, and consumers who would be covered by that bonding.

Section 1741.5, Subsection (c)(6)(B)

Subsection (c)(6)(B) of section 1741.5 would require the CPA to perform the following procedures on the trust account bank reconciliation and bank statements for all types of escrow transactions.

Section 1741.5, Subsection (c)(6)(B)(i)

Subsection (c)(6)(B)(i) of section 1741.5 would require the CPA to confirm that the escrow liability in the fiscal year-end trust account bank reconciliation agrees with the ending reconciled escrow trial balance. This is necessary to determine whether the licensee is properly reconciling its trust account with its escrow liability. This benefits the Department and consumers because if the CPA notes deficiencies, the Department can act to gain compliance.

Section 1741.5, Subsection (c)(6)(B)(ii)

Subsection (c)(6)(B)(ii) of section 1741.5 would require the CPA to confirm that the fiscal year-end total of receipts and receipt adjustments issued, checks and check adjustments issued, and incoming and outgoing wires and wire adjustments issued as shown on the trust account bank reconciliation agree with the respective totals on the month-end receipts and adjustments register, checks and adjustments register, incoming and outgoing wires and adjustments register, and any other item that is shown on the trust account bank reconciliation that represent activity during the month. Reconciliation of the trust account will allow a CPA and a licensee to identify discrepancies which may cause trust shortages and losses of consumer funds if not corrected timely. This is also

necessary to determine whether the licensee is properly reconciling its trust account with its escrow liability. This benefits the Department and consumers because if the CPA notes deficiencies, the Department can act to gain compliance.

Section 1741.5, Subsection (c)(6)(B)(iii)

Subsection (c)(6)(B)(iii) of section 1741.5 would require the CPA to determine if the balances on the escrow trial balance and escrow liability controlling account for the last day of the fiscal year, including adjustments, are not reconciled to the trust account bank balance as required by section 1732.2 of these rules. If they are not reconciled, the CPA must indicate in the report of findings that the licensee has failed to reconcile its trust account and indicate any subsequent corrective action taken by the licensee. This procedure requires CPAs to report whether a licensee corrected the reconciling item by the time the CPA issues the audit report. This information allows the Department to determine whether corrective action was promptly taken, and whether the Department needs to commence an examination to resolve reconciling items not corrected by a licensee. This is necessary to determine whether the licensee is properly reconciling its trust account with its escrow liability. This benefits the Department and consumers because if the CPA notes deficiencies, the Department can act to require compliance.

Section 1741.5, Subsection (c)(6)(B)(iv)

Subsection (c)(6)(B)(iv) of section 1741.5 would require the CPA to verify the accuracy of the total stated number of escrows with balances shown on the fiscal year-end escrow trial balance. This is necessary to ensure that the escrow trial balance is properly stated. This balance is used in reconciling the trust account; therefore, this benefits the Department and consumers because if the CPA notes deficiencies, the Department can act to gain compliance.

Section 1741.5, Subsection (c)(6)(B)(v)

Subsection (c)(6)(B)(v) of section 1741.5 would require the CPA to inspect the escrow trial balance for debit balances at the balance sheet date. For every debit balance identified, it requires the CPA to inquire and provide in the report of findings the licensee's explanation of the nature, cause, and resolution of the debit balance. The CPA must inspect the underlying documentation supporting the applicable escrow ledger entries creating the debit balance and confirm that the underlying documentation supports the licensee's description of the nature, cause and resolution of the debit balance. If any debit balance remains as of the annual report date, the CPA must indicate in the report that the debit balance has not been resolved. If no debit balance is identified in the review of the escrow trial balance at the balance sheet date, the CPA must indicate in the report of findings that the escrow trial balance was reviewed for debit balances and none was identified. This is necessary because debit balances can represent trust shortages and licensees are required to correct them when noted. This benefits the Department in determining whether the licensee should be immediately examined if the report indicates that the debit balances were not merely posting errors or not corrected.

Section 1741.5, Subsection (c)(6)(B)(vi)

Subsection (c)(6)(B)(vi) of section 1741.5 would require the CPA to inspect the trust account bank statements and reconciliations of all trust accounts as of the balance sheet date to confirm that the bank accounts are reconciled to adjusted book balances and confirm that documentation supports the disposition of the reconciling items appearing in the trust account bank reconciliations. The CPA must inspect management's description of the reconciling items to confirm that that the description is not contradicted or otherwise unsupported by the underlying documentation. The CPA must indicate in the report of findings whether the disposition of the reconciling items (1) is supported by underlying documentation, and (2) results in a trust account debit balance. This is necessary to determine whether the licensee is properly reconciling its trust account with its escrow liability and its treatment of reconciling items. This benefits the Department and consumers because if the CPA notes deficiencies, the Department can act to gain compliance or immediately initiate an examination at the company.

Section 1741.5, Subsection (c)(6)(B)(vii)

Subsection (c)(6)(B)(vii) of section 1741.5 would require the CPA to confirm that the fiscal year-end trust account bank reconciliation accurately classifies escrow liability book adjustments from bank balance adjustments to reflect adjusted ending escrow liability book balance and bank balance. The purpose of this proposed subsection is to accurately reflect any adjustments on the reconciliation. This is needed to ensure that adjustments are properly recorded to avoid the hiding of trust shortages. This will benefit the Department and the public because if trust shortages exist there may not be enough funds to pay the customers.

Section 1741.5, Subsection (c)(6)(B)(vii)(I)

Subsection (c)(6)(B)(vii)(I) of section 1741.5 would require the CPA to confirm that descriptions of all reconciling items include information regarding the escrow and escrow ledgers affected, and the date and event that created the reconciling item. The proposed rule would also require the CPA to confirm that reconciling items to be adjusted to either the escrow liability book balance or bank balance include a statement indicating the reason for the adjustment. This is necessary because misclassified accounting adjustments as bank adjustments can indicate that the escrow liability is understated, and that a trust shortage exists. This benefits the Department and consumers when deficiencies are noted, the Department can take immediate action.

Section 1741.5, Subsection (c)(6)(B)(vii)(II)

Subsection (c)(6)(B)(vii)(II) of section 1741.5 would require the CPA to confirm that the underlying escrow ledger and source documents of each reconciling item substantiate each reconciling item and explain each reconciling item in the report of findings. The proposed rule would require the explanation to include: (1) the escrow number, (2) receipt number or check number, (3) cause and resolution of the reconciling item, and (4) date of adjustment. Also, it would also require the CPA to indicate whether the adjustment of the reconciling item causes a debit balance. This is necessary to ensure that the CPAs are reviewing the licensee's records that support the proper identification and correction

of the adjustment. This benefits the Department by determining whether adjustments on the bank reconciliation are properly identified and whether trust shortages exist.

Section 1741.5, Subsection (c)(6)(B)(vii)(III)

Subsection (c)(6)(B)(vii)(III) of section 1741.5 would require the CPA to, if any reconciling item is outstanding as of the annual report date, include this information in the report of findings and provide the licensee's anticipated date of resolution. This is necessary in determining whether the licensee has corrected all the reconciling adjustments. The Department benefits because if adjustments are not corrected, follow-up can be initiated to confirm the adjustments were eventually corrected.

Section 1741.5, Subsection (c)(6)(B)(viii)

Subsection (c)(6)(B)(viii) of section 1741.5 would require a CPA to confirm the account balance of every trust account through either written correspondence with the depository institutions or through an online platform that allows access directly to bank records that cannot be retrospectively altered except by the depository institution. The confirmation of account balances must include all accounts containing escrow funds, including interest bearing accounts, dormant accounts, and trust accounts maintained separately by the licensee for transactions not specified in Financial Code section 17312, subdivision (c). This is necessary to ensure that the balances appearing on the trust reconciliations have been vetted. This benefits the Department by providing assurance that the bank reconciliations are accurate.

Section 1741.5, Subsection (c)(6)(B)(ix)(I)-(IV)

Subsection (c)(6)(B)(ix) of section 1741.5 would require a CPA to compare and reconcile the bank name, account number, and balance at the fiscal year-end on each trust account statement to the trust account bank reconciliation. This would require the CPA to: (1) confirm that every account containing trust funds is designated as a trust or escrow account; (2) trace each ending bank balance appearing on the respective trust account bank reconciliation to the related bank confirmation and bank statement; (3) indicate in the report of findings whether any differences exist; and (4) if differences are identified, state the resolution or the differences that remain unresolved at the report date. The procedures confirming that accounts are correctly designated and comparing the ending bank balances on the accounts to the bank statements are necessary to confirm that the bank accounts appearing on the trust account reconciliation exist and are designated trust accounts. Indicating whether any differences exist in the report of findings requires CPAs to compare bank information on the bank statement with bank information on the bank reconciliation report and report differences in their findings. This procedure is necessary to ensure bank information is accurately reflected on the reconciliation report. Bank information may change due to various reasons. For example, a licensee may request a bank to close an existing account and transfer funds to open a new trust account due to a cyber-attack or due to a large number of fraudulent checks being presented to the bank from fraudsters. A licensee's bank's name may also change due to merger or acquisition. When bank information changes, the current information about a licensee's bank should be correctly reflected on the reconciliation report. The

procedure will help the CPAs to report anomalies to the Department so it may investigate whether trust accounts are being properly maintained by licensees. The procedure to state unresolved differences requires CPAs to report differences between bank information on the bank statement and the bank information on the trust bank reconciliation report to the Department and state the resolution or that the differences remain unresolved at the report date. This procedure is necessary to report a licensee's corrective action or the lack thereof to the Department in order for the Department to review and take appropriate action. It benefits CPAs to clarify the requirement so CPAs may consistently apply this procedure, and it also benefits the Department to have the reported information to support any inquiries, reviews, or investigation into the differences.

These procedures benefit the Department by determining whether the information contained on the trust reconciliation can be relied upon.

Section 1741.5, Subsection (c)(6)(B)(x)(I-V)

Subsection (c)(6)(B)(x) of section 1741.5 would require a CPA to perform specific procedures related to checks. The procedures outlined in this section are to verify that the bank reconciliation contains accurate information regarding the outstanding checklist by confirming the balance, reviewing the checklist for checks that should have been included that were not, and reviewing the checklist for checks that have cleared or been canceled. This section also instructs CPAs to sample checks for proper authorization to the payees and proper endorsements.

The procedures in this proposed rule are necessary to provide CPAs guidance on how to prepare the annual report regarding checks. The procedures are necessary to ensure that CPAs are consistent in their review of the licensees' trust account bank reconciliations. These procedures will provide a benefit to the Commissioner and consumers by ensuring that the licensees' trust reconciliations will be reviewed consistently and accurately so that the Commissioner will be aware of and address issues with licensees that may impact the consumers so that their funds may be protected.

In subsections III-V, various sampling minimums are set forth for checks. The various sampling minimum determinations were based on the type of check review. Each check review procedure requires different levels of review by CPAs. The difference in required levels of review determines the various sampling minimums. If a check review requires extensive research and validation, the minimum sample may be smaller, while a review that does not require extensive research and validation may require a larger sample.

Section 1741.5, Subsection (c)(6)(B)(x)(I)

Subsection (c)(6)(B)(x)(I) of section 1741.5 requires a CPA to independently calculate the total amount of outstanding checks and confirm the calculated total with the total amount of outstanding checks on the trust bank reconciliation report provided by the management of an escrow company. This procedure is necessary to confirm the trust bank reconciliation report is correctly balanced and the total dollar amount of outstanding

checks is not manipulated to balance the reconciliation. This procedure provides a benefit to the Department by ensuring that the licensees' trust reconciliations will be prepared consistently in balancing the amount of outstanding checks.

Section 1741.5, Subsection (c)(6)(B)(x)(II)

Subsection 1741.5(c)(6)(B)(x)(II) of section 1741.5 requires a CPA to review check numbers to ensure checks were consecutively issued and to ensure there were no missing checks. It also requires a CPA to verify and confirm the amounts of outstanding checks with the amounts of checks on the check register. This procedure is necessary to ensure trust checks are accounted for, and that trust checks are properly issued for the correct amounts. A gap in consecutive check numbers is an indication of missing checks. All missing checks need to be accounted for and properly recorded or stop-paid to protect the integrity of the trust account. This procedure provides a benefit to the Department and consumers by ensuring trust checks are properly maintained and correctly accounted for. Any anomalies identified by this procedure may be the basis for the Department to conduct an exam to review a licensee's trust check maintenance and trust fund disbursements.

Section 1741.5, Subsection (c)(6)(B)(x)(III)

Subsection 1741.5(c)(6)(B)(x)(III) of section 1741.5 requires a CPA to review a sample of at least 25 checks issued during the last two months of the fiscal year-end to determine whether checks are properly accounted for. This procedure is necessary to confirm whether licensees are properly maintaining checks and whether they are working with their bank to resolve check issues. This benefits the public by ensuring trust checks are properly maintained and accounted for to safeguard consumer trust funds.

Section 1741.5, Subsection (c)(6)(B)(x)(IV)

Subsection 1741.5(c)(6)(B)(x)(IV) of section 1741.5 requires a CPA to review and trace a sample of at least 25 cleared checks to determine whether the sample checks were properly issued and endorsed by the appropriate check payees. This procedure is necessary to determine whether there are any fraudulent checks or checks issued to principals but endorsed by escrow employees. This benefits the Department and the public by ensuring trust checks are properly issued and endorsed by appropriate parties.

Section 1741.5, Subsection (c)(6)(B)(x)(V)

Subsection 1741.5(c)(6)(B)(x)(V) of section 1741.5 requires a CPA to review at least 50 check authorizations and any unusual disbursements that may constitute paying referral fees. It also enables CPAs to report any embezzlement or misappropriation of trust funds directly to the Department if management of the escrow company cannot confirm such embezzlement or misappropriation of trust funds have already been reported to the Department. This is necessary to allow CPAs to directly report embezzlement or misappropriation of trust funds to the Department so the Department can commence an immediate review of the matter and request licensees to replace shortages, if any. This is beneficial to the Department and the public because it allows

information about embezzlement or misappropriation to be directly reported by CPAs to the Department for quick action to ensure trust shortages are promptly cured.

Section 1741.5, Subsection (c)(6)(B)(xi)

Subsection (c)(6)(B)(xi) of section 1741.5 would require a CPA to confirm the date and amount of the deposits in transit at the fiscal year-end by performing the following procedures. The rule would require the CPA to (1) trace the deposits in transit on the trust account bank reconciliation to recorded receipts, the subsequent month bank statement, and source documents; and (2) indicate in the report whether any deposits in transit were deposited more than two business days after receipt. Tracing the deposits is necessary to ensure that deposits in transit shown on the bank reconciliation exist and are properly recorded. Indicating in the report if deposits were deposited more than two days after receipt is necessary to ensure funds are timely deposited to the trust account pursuant to California Code of Regulations, title 10, section 1737, which requires trust funds to be deposited on or before the close of the next full working day after receipt. A late deposit may cause a short in the trust account if funds are not timely credited to the bank to cover all disbursements upon close of an escrow transaction. These procedures benefit the Department and the public by providing some assurance that the trust reconciliation is properly stated.

Section 1741.5, Subsection (c)(6)(B)(xii)

Subsection (c)(6)(B)(xii) of section 1741.5 would require a CPA to trace a sample of at least ten bank returned deposits appearing on the fiscal year-end month trust account statements to the source documents. The proposed rule would also require a CPA to identify in the report whether a bank debit memo creates a debit balance, or a bank credit memo corrects the debit balance on the escrow ledger. If less than ten returned deposits appear on the fiscal year-end month trust account statements, the CPA should trace all the bank returned deposits on the statement and report that all returned deposits appearing on the bank statements were traced. For purposes of this paragraph, a bank-returned deposit is an intended transaction, either check, wire or other deposited item, in a trust account that is not honored or is reversed by a bank. These procedures are necessary to confirm that the trust reconciliation is accurate regarding deposited funds. This benefits the Department and the public by allowing for reliance on the trust reconciliation.

The Department determined that ten returned deposits was an appropriate amount because if the number of returned items was greater than ten it may trigger an inquiry or examination of the company to investigate the reason and pattern for the returned items. Typically, there should not be many returned deposits reflected on a company's bank statement. It is unusual to see more than ten returned items. The definition of a "bank-returned deposit" clarifies that a returned deposit encompasses checks, wires or other deposited items such as ACH transfers, so a CPA's review is not limited to just the returned checks. This clarification allows CPAs to determine the scope of this review procedure to include reviews of debit memos as a result of returned checks, reversed wires or ACH, and other related transactions.

Section 1741.5, Subsection (c)(6)(B)(xiii)

Subsection (c)(6)(B)(xiii) of section 1741.5 would require a CPA to, if the licensee has more than one trust account, and transfers of cash between the trust accounts were made within five days of the fiscal year-end date, confirm the cash receipt and disbursement dates on the escrow ledgers to test for kiting. The CPA must identify any evidence of kiting in the report of findings and report such activity to the Commissioner in accordance with the terms of the engagement, no more than 3 business days after discovery. For purposes of this paragraph, kiting means the process whereby cash is recorded in more than one bank account, but in reality, the cash is either nonexistent or is in transit. This is necessary because kiting between bank accounts is an indication that there could be a trust account shortage. This benefits the Department and the public by providing some assurance that the trust account is properly reconciled.

The Department determined that five days is a sufficient period of time to test for check kiting because a typical deposit will be cleared by a bank within five days from the date the deposit was made. Any deposit in transit item that is more than five days old should be reviewed for possible check kiting. The Department also determined that upon identifying check kiting, a three-day period is sufficient time for a CPA to validate check kiting and compile all evidence with substantiation to report the matter to the Department. This procedure identifies any possible check kiting. It is necessary to ensure licensees are not misusing trust checks as unauthorized credit to cover trust account shortages. The example of kiting contained in the subsection is necessary to clarify how a typical check kiting scheme would appear on the escrow ledger and account. The example would also help CPAs identify check kiting. This subsection benefits the Department and the public by protecting funds in the trust account.

Section 1741.5, Subsection (c)(6)(B)(xiv)

Subsection (c)(6)(B)(xiv) of section 1741.5 would require a CPA to, if the licensee maintains one set of books that includes more than one trust account, confirm each adjusted bank balance as of the fiscal year-end. If the accounting records do not reflect the bank statement balances and the list of outstanding checks for each trust account separately, the CPA should include a description of which trust account is affected by each bank adjustment. The CPA must confirm that the total of all adjusted bank balances is equal to the adjusted escrow liability balance for the fiscal year-end month. The CPA must confirm that the licensee separately reconciles each dormant trust account. This is necessary to understand which bank account each adjustment affects when there is more than one bank account represented on the trust reconciliation. This benefits the Department in reviewing the bank reconciliation to determine that each trust account is properly reconciled even when combined in one trust reconciliation.

Section 1741.5, Subsection (d)

Subsection (d) of section 1741.5 would specify what additional documentation obtained from the licensee the CPA would be required to include in the annual report. This is necessary to impress upon the CPA that all additional required documents must

be included with the report. This benefits the Department and the public in reviewing the reports for consistency and adequate reporting of the parts to the trust reconciliation.

Section 1741.5, Subsection (d)(1)(A) and (B)

Subsections (d)(1)(A) and (d)(1)(B) of section 1741.5 would require the CPA to include copies of the trust account bank reconciliations for all trust accounts at each location as of the balance sheet date, including all interest bearing and dormant accounts and any other accounts held in trust by the licensee. Subsection (d)(1)(A) would specify that the trust account bank reconciliations must include an explanation for each adjustment, including the date of the adjustment, and a list of outstanding checks, which must include check and escrow numbers, the names of the payees, dates and amounts for each check. Subsection (d)(1)(B) would specify that the trust account bank reconciliations are subject to public disclosure under the California Public Records Act[10] upon the Department's redaction of account numbers, identifiable payee information, and other nonpublic information. This rule is necessary to ensure that the trust bank reconciliation and supporting documents are included in the report. It also specifies what will happen with personally identifiable information. This benefits the Department who reviews the trust account bank reconciliations for accuracy and completeness and assures the public that their personally identifiable information will be safeguarded.

Section 1741.5, Subsection (d)(2)

Subsection (d)(2) of section 1741.5 would require the CPA to include in the annual report an escrow trial balance as of the fiscal year-end trust account bank reconciliation date. If applicable, the CPA must provide a separate escrow trial balance as of the fiscal year-end trust account bank reconciliation date for the types of transactions specified in Financial Code section 17312, subdivision (c), and the types of transactions not specified in the section. The trial balances submitted with the annual report containing identifiable customer information are subject to public disclosure under the California Public Records Act upon the Department's redaction of identifiable customer information and other nonpublic information. This is necessary to inform the CPA that the escrow trial balances for both EAFC covered and noncovered transactions must be included in the report. It also provides guidance on what will happen to personally identifiable information. This benefits the Department and the public in the review of the trust reconciliation for accuracy and the disposition of personally identifiable information.

Section 1741.5, Subsection (d)(3)

Subsection (d)(3) of section 1741.5 would require the CPA to include in the annual report the month-end escrow liability report, which must indicate the balance at the end of each month during the fiscal year as reflected in adjusted book balance with separate reports for escrows covered and not covered by the EAFC. This rule is necessary to calculate the company's bond requirements and to confirm adequate bonding is on file with the Department. This benefits the Department and protects the public by confirming the company has adequate bond coverage.

[10] Gov. Code, § 6250 *et seq.*

Section 1741.5, Subsection (d)(4)

Subsection (d)(4) of section 1741.5 would require the CPA to include in the annual report a list of the addresses of every branch location. This is necessary to ensure that all locations of the licensee are included in the report. This benefits the Department by confirming that the report covers all the licensee's locations and thereby all the licensee's escrow business.

Section 1741.5, Subsection (d)(5)

Subsection (d)(5) of section 1741.5 would require the CPA to include in the annual report a copy of the licensee's fee ledger at the balance sheet date, for fees receivable that are included as a liquid asset on the licensee's balance sheet. This rule is necessary to verify that if there is a fee receivable included in the liquid asset calculation that the amount of the receivable is documented with proof that the fees exist and had not been transferred to the general account at the balance sheet date. This benefits the Department by confirming the cash assets included in the net liquid asset calculation exist.

Section 1741.5, Subsection (e)

Subsection (e) of section 1741.5 would authorize the Commissioner to grant a variance upon a finding that a variance is in the public interest upon request if, in the opinion of the CPA, a departure from the requirements set forth in this section is justified. This rule is necessary because there may be instances where the instructions should be modified for a specific reason that the CPA believes is justified. This gives the Department flexibility to waive requirements in circumstances where the Department and the CPA believe it would be appropriate.

Section 1741.5.1, Subsection (a)

Subsection (a) of section 1741.5.1 would require a licensee seeking to surrender its license to enter into an engagement with a CPA to perform the procedures in this section. The CPA must be independent of the licensee in accordance with California Code of Regulations, title 16, section 65. The performance of the procedures and reporting requirements must be in accordance with national attestation engagement standards applicable to CPAs. In the past, some CPAs would refuse to perform supplemental procedures under the current California Code of Regulations, title 10, section 1741.5 because they claimed performance of these procedures was a violation of their professional conduct standards. This language clarifies that the closing audit procedures must be in accordance with national attestation engagement standards, so that performing these procedures will not place CPAs at risk of violating their professional conduct standards. This benefits the CPA and the Department by allowing the CPA to use procedures that conform to the AICPA rules, allowing the CPA to prepare a report that contains the elements needed by the Department in determining whether the surrender of the escrow agent's license is in the interest of the public.

Section 1741.5.1, Subsection (b)

Subsection (b) of section 1741.5.1 would require a licensee to engage a CPA to perform specified procedures. This is necessary to outline that there are specific procedures that must be performed by the CPA in the preparation of the closing report. This rule benefits the licensees by specifying the procedures that must be performed before the surrender will take effect.

Section 1741.5.1, Subsection (b)(1)

Subsection (b)(1) of section 1741.5.1 would require a licensee to engage a CPA to obtain directly from the licensee's financial institution three complete calendar months of bank statements: the month prior to the cessation of business of the licensee, the month of cessation of business, and the month following that date. For the same three months, it would require the CPA to obtain the trust account bank reconciliations, the list of outstanding checks, the escrow trial balances, and all other subsidiary listings such as receipts, checks, incoming and outgoing wires, and adjustments. This requirement is necessary to inform the CPA and the licensee what records are required for a closing report. It is necessary for the CPA to review bank transaction activities and escrow activities in the months before, during, and after cessation of business to reasonably conclude all trust funds are appropriately escheated or disbursed to the respective parties to escrow transactions, and not taken as unauthorized fees or disbursed to unauthorized parties. Reviewing the trust reconciliation for the month after business cessation will disclose whether any outstanding checks or wires have been cleared by the bank. This requirement ensures trust funds are properly maintained and handled during the surrender process when an escrow company scales down its staffing and operations during its surrender. The procedure is also necessary to ensure a licensee is winding down its business and taking appropriate actions to clear its outstanding liabilities. This benefits the Department because the bank reconciliations indicate the amount of funds remaining in the trust account and how the funds were handled after the license was surrendered.

Section 1741.5.1, Subsection (b)(2)

Subsection (b)(2) of section 1741.5.1 would require a licensee to engage a CPA to follow the trust account bank reconciliation procedures in section 1741.5, subsection (c)(6)(B) of these rules on the trust account bank reconciliation for the calendar month following the month that business ceased. It would require the CPA to indicate each procedure and the results of each procedure in the report of findings. For the calendar month prior to the month that business ceased, and the calendar month during which business ceased, it would require the CPA to verify that the reconciling items are supported by the underlying documentation and that any debit balances were corrected. This rule is necessary because it informs the CPA and the licensee of the procedures that the CPA must perform to produce an acceptable closing report. Requiring the CPA to include the procedures in the report will also help ensure that he or she will perform all of the procedures. This will help ensure that the Department receives a complete report that includes an overview of a licensee's books, records and financials. The procedure is also necessary to ensure the licensee will continue to reconcile its trust account after its business has ceased. This benefits the public by ensuring that the Department

receives closing reports that are consistent and contain the information required by Financial Code section 17600.

Section 1741.5.1, Subsection (b)(3)

Subsection (b)(3) of section 1741.5.1 would require a licensee to engage a CPA to inspect the escrow ledgers of each escrow that includes an entry for 60 days prior to the cessation date of business and inspect the escrow ledgers with entries after the date of cessation of business, to confirm that no escrow funds have been disbursed without authorization. The rule would require the CPA to identify escrow funds that appear to have been disbursed in an unusual manner, such as those transactions described in section 1741.5, subsection (c)(6)(B)(x)(V) of these rules. Further, the rule would require the CPA to request that the licensee explain every unauthorized or unusual disbursement, and identify each unauthorized or unusual disbursement, and the licensee's explanation for the disbursement, in the report. It would require the CPA to include a statement in the report that no unauthorized disbursement of funds was found, if applicable. This rule is necessary in order to determine whether the escrow agent made unauthorized disbursements shortly before ceasing operations as an escrow agent. The procedures are necessary to review the disposition of trust funds to ensure trust funds are not being used to pay escrow employees or a company's operation expenses. This rule benefits the Department and the public in determining whether the escrow agent took funds not belonging to it at or prior to the closing of its business. It also benefits the public in knowing that any unclaimed funds can be accessed by contacting the State Controller's Office.

The Department determined it is appropriate to inspect ledgers for 60 days because a 60-day period would cover the typical life span of an escrow transaction. Any escrows with funds deposited within a 60-day period prior to the cessation date would have disbursements close to the cessation date and require closer review to ensure a licensee is not mishandling trust funds to pay for its business expenses and employee compensation.

The Department determined a CPA should request that a licensee explain every unauthorized or unusual disbursement, and then include each unauthorized or unusual disbursement with the licensee's explanation for the disbursement, in the report, to enable it to better assess the disbursements. Unauthorized and unusual disbursements may be made by either the owner of the company or an escrow staff. A CPA's request for written explanation will require the company to conduct a review of unauthorized disbursements, identify responsible persons who made the unauthorized disbursements, take prompt personnel action against the person, and report the unauthorized disbursements to both the Department and EAFC.

Section 1741.5.1, Subsection (b)(4)

Subsection (b)(4) of section 1741.5.1 would require a licensee to engage a CPA to determine whether any escrows were opened after the Department was notified of the licensee's cessation of business date. It would also require the CPA to indicate in the report whether any escrow was opened during this time period and provide the status of

the escrow. This is necessary to determine that the escrow agent ceased operations when the license was submitted to the Department for surrender and that no unlicensed escrows were performed. This procedure enables a CPA to isolate a transaction opened after a licensee notifies the Department of its license surrender. A closing audit is due to the Department 105 days after a licensee notifies the Department, pursuant to Financial Code section 17406. If an escrow transaction opens after the notification date and is not closed within 105 days or before the practitioner issues a closing audit report, the Department needs to have information about the transaction to conduct its own review for the final disposition of trust funds before it accepts a licensee's surrender of its license. This rule benefits the Department by enabling it to determine if additional procedures are needed in the verification that all trust funds have been properly disbursed.

Section 1741.5.1, Subsection (b)(5)

Subsection (b)(5) of section 1741.5.1 would require a licensee to engage a CPA to identify the escrows opened during the 45 days prior to the cessation of business. It would require the CPA to examine the dispositions of these escrows for any unusual activity and describe the unusual activity in the report of findings. This rule is necessary to determine what happened to the last escrows that were opened by the licensee, such as whether the transactions were closed by the licensee or were transferred to another escrow agent for closing. The Department determined that identifying escrows opened 45 days prior to a company's cessation of business date is necessary to confirm a company's intention to cease business. Prior to TILA[11]-RESPA[12] Integrated Disclosure (TRID)[13], most federally related mortgage loans could close escrow within 30 days. While TRID requires clear disclosure to consumers, it also extends a closing from 30 days to 45 days for a typical escrow transaction. This information enables the Department to track a licensee's escrow activities during its wind-down period. This also benefits the Department and the public by determining whether any remaining transactions were either properly closed or transferred to another escrow agent for closing.

Section 1741.5.1, Subsection (b)(6)

Subsection (b)(6) of section 1741.5.1 would require a licensee to engage a CPA to verify whether the licensee has escheated all remaining trust funds in accordance with California Code of Civil Procedure section 1517. The rule would also require the CPA to describe in the report of findings whether all trust funds have been escheated to the state. This is necessary to ensure that any remaining trust funds were properly escheated to the State Controller's Office and allows consumers to view and submit a request to claim such funds. This benefits the public by avoiding forfeiture of unclaimed funds with a proper claim to the State Controller's Office.

Section 1741.5.1, Subsection (b)(7)

[11] Truth in Lending Act
[12] Real Estate Settlement Procedures Act
[13] 12 C.F.R. § 1026.

Subsection (b)(7) of section 1741.5.1 would require a licensee to engage a CPA to include in the report of findings the name, phone number, and address of the appointed custodian of records and the location address of the escrow files and accounting records. This is necessary to ensure that the Department's records are up to date with the contact information of the person responsible for the licensee's records and the location of the books and records. California Code of Regulations, title 10, section 1737.3 requires an escrow company to keep its records for at least five years from the close of escrow. Subsection (b)(7) of section 1741.5.1 will ensure the Department has access to records during the five-year period after the license is surrendered, which is necessary to retrieve the company's records in case (1) an issue comes to the Department's attention requiring access to the records after the closing of the company or (2) former customers contact the Department asking for copies of documents from their escrow files. This benefits the Department and former customers who contact the Department when copies of documents contained in their escrow files are needed after the escrow company has ceased operations.

Section 1741.5.1, Subsection (c)

Subsection (c) of section 1741.5.1 would require a licensee to ensure the CPA performs all of the procedures required by this rule. It would also require the licensee to ensure the CPA includes in the closing report of findings a description of all the above procedures performed and the results of each procedure. The content of a CPA's report is based on the information provided by an escrow company's management. Thus, this rule is necessary to ensure that the closing report contains all the required elements and makes the licensee legally responsible for the complete content of the report. This benefits the Department and the public by ensuring they will have access to a report that is consistent with the procedures set forth in this rule.

Section 1741.5.1, Subsection (d)

Subsection (d) of Section 1741.5.1 would require a licensee to ensure its CPA submit the report of findings directly to the Commissioner. The rule would also require the licensee to ensure that the CPA includes in the report a copy of the trust account bank reconciliations, bank statements, list of outstanding checks, trial balances, and proof of remittance of all remaining trust funds to the State Controller's Office, for the months specified. This rule is necessary to ensure that the CPA submits the report directly to the Department and that the report contain all the required documents. This benefits the Department and the public by ensuring that the Department receives a report that has not been altered by the licensee for issues it would not want the Department or the public to know about.

Section 1741.7, Subsection (a)

Subsection (a) of section 1741.7 would prohibit a licensee from performing specified activities, directly or indirectly, and deem the activities compensation for referring, soliciting, handling or servicing escrow customers or accounts. These activities include: (1) Paying, furnishing, or providing assistance with the business expenses of any person; (2) Advertising or paying for the advertising in specified mediums which enable

users to create and share content or to participate in social networking on behalf of any person; (3) Sharing content generated by or on behalf of another person on the Internet or an application which enables users to create and share content or to participate in social networking; (4) Expenditures for foods, beverages and entertainment for a person or catering events; (5) Furnishing all or any part of the time or productive effort of any employee of the escrow agent to any person for any service unrelated to the escrow business; and (6) Escrow services offered for special rates below market value or for free, unless the amounts of escrow fees being charged or not being charged to one or more parties of a transaction are mutually agreed upon as substantiated by written escrow amendments and that the amount of fees be explicitly disclosed on the written instruction. Existing Escrow Law, Financial Code section 17420, lacks clarity regarding escrow referral compensations. Federal law specifies what activities are not prohibited as "kickbacks" under the Real Estate Settlement Procedures Act (RESPA).[14]

The inconsistency between state and federal law has been an issue for years, but worsened when the California Insurance Law was amended to describe what activities are prohibited as "business referrals" by title companies.[15] This descriptive prohibition strongly contrasts with the vague statute in the Escrow Law, which has caused confusion in the independent escrow industry. However, the Department has always prohibited escrow referral fees even though current law lacks the descriptive provisions. The rule is necessary to more clearly indicate what activities are considered to be prohibited as referral fees and kickbacks. Generally, these activities create an arrangement between the escrow agent and parties who may refer escrow transactions to the escrow agent. This arrangement is mutually beneficial for the escrow agent who may receive more business and for the referring parties who receive a fee for making such a referral. The proposed prohibited activities are common RESPA violations reported to the Department by the escrow industry. RESPA violations are also escrow violations pursuant to Financial Code section 17425. In order to prove one of these activities is an escrow violation due to association with a RESPA violation, the Department must find a RESPA violation.[16] These activities are not clearly defined under the current referral fee provision in Financial Code section 17420. Therefore, this section is necessary to provide clarity to the industry what activities are considered prohibited activities under RESPA and Escrow Law, and also necessary for the Department to enforce the Escrow Law to prevent kickbacks that harm consumers. This will help protect the public's right to choose an escrow company, by eliminating realtors and other persons who use escrow companies from being persuaded to use certain escrow companies based on their kickbacks.

Section 1741.7, Subsection (b)

Subsection (b) of section 1741.7 would specify that in order for an arrangement of an escrow agent paying over to any other person any commission, fee, or other consideration to be considered compensation for referring, soliciting, handling, or

---

[14] 12 U.S.C. § 2607.

[15] SB 133 (Aanestad, Chapter 280, Statutes of 2008).

[16] This quid pro quo is a violation of the Real Estate Settlement Procedures Act (RESPA) and therefore prohibited under the Escrow Law pursuant to Financial Code section 17425, which provides that any persons subject to the Escrow Law who violate RESPA violate the Escrow Law.

servicing escrow customers or accounts, the arrangement need not be written or verbalized but may be established by practice, pattern or course of conduct. Under current law, the Department has to show a connection between a licensee paying compensation to a broker referring an escrow. The problem is that sometimes the Department may receive evidence about a company providing such compensation, but not have access to a contract that shows there was an agreement about the compensation. And often times, such agreements are verbal between escrow agents and brokers. The Department interprets the law to prohibit kickbacks even when no express agreement exists.

Potential for Adverse Economic Impact on Business and Individuals [Gov. Code, § 11346.3, subd. (a)]

The Commissioner has determined that it is unlikely that the proposed regulatory action will have an adverse economic impact or potential for an adverse economic impact on business, including the ability of California businesses to compete with businesses in other states, or individuals. The Department anticipates that a licensee will incur an additional cost related to the need for two separate audit engagements for the annual report. However, the substantive audit requirements that are being moved from an audit of financial statements to an agreed-upon procedures engagement have been in Rule 1741.5 since 2002, and therefore no additional field work is required for the agreed-upon procedures engagement. Consequently, while the amendments to the rule will require the former single audit report to be separated into two parts and two separate engagements, the workload will remain substantially the same.

As a result, the Department anticipates that the typical cost for a licensee to amend its past audit procedure to comply with the new audit procedure required by this proposed rulemaking will be $1,000 or less. The current rule does not specify the procedures a CPA must perform to make the statements required in the report. The procedures proposed in the proposed regulation may be different than those previously used by CPAs. Therefore, the time to perform them may vary slightly for different CPAs. Also, some proposed requirements will require smaller samples, which will reduce the time necessary to perform those procedures. While there may be additional costs to some licensees based on the new closing audit procedures, other licensees may realize savings.

Conversely, the protections and benefits of these rules are expected to better assess the financial condition of escrow agents and in turn help ensure the safety of the public's funds held by escrow agents.

Standardized Regulatory Impact Analysis [Gov. Code, § 11346.2, subd. (b)(2)]

This regulatory action does not involve a major regulation.

Economic Impact Assessment [Gov. Code, § 11346.3, subd. (b)]

A. The Creation or Elimination of Jobs Within the State

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation or elimination of jobs in the State of California. The Department anticipates that a licensee will incur an additional cost related to the need for two separate audit engagements for the annual report. However, the substantive audit requirements that are being moved from an audit of financial statements to an agreed-upon procedures engagement have been in Rule 1741.5 since 2002, and therefore no additional field work is required for the agreed-upon procedures engagement. Consequently, while the amendments to the rule will require the former single audit report to be separated into two parts and two separate engagements, the workload will remain substantially the same. As a result, the Department anticipates that the typical cost for a licensee to amend its past audit procedure to comply with the new audit procedure required by this proposed rulemaking will be $1,000 or less.

The current rule does not specify the procedures a CPA must perform to make the statements required in the report. The procedures proposed in the proposed regulation may be different than those previously used by CPAs. Therefore, the time to perform them may vary slightly for different CPAs. Also, some proposed requirements will require smaller samples, which will reduce the time necessary to perform these procedures. While there may be additional costs to some licensees based on the new closing audit procedures, some licensees may realize savings.

The protections and benefits of these rules are expected to better analyze the financial condition of escrow agents and in turn help ensure the safety of the public's funds held by escrow agents.

<u>B. The Creation of New Businesses or the Elimination of Existing Businesses Within the State</u>

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation of new businesses or the elimination of existing businesses in the State of California because the proposed regulations are only intended to respond to the escrow industry's request to resolve a compliance issue with CPA professional standards.

In early 2013, the Department identified that some annual reports submitted on behalf of licensees under Rule 1741.5 did not contain unqualified opinions regarding the procedures performed under Rule 1741.5 and section 17406 of the Escrow Law. In follow-up correspondence, the Department was advised that the CPAs would be violating their professional standards to provide opinions on audit procedures defined by a third party. The CalCPA advised the Department that an agreed-upon procedures report is the appropriate approach to the reporting consistent with the regulation.

On July 24, 2013, the Department met with interested parties to discuss potential ways to resolve the CPA compliance issue while still providing the Department with an annual report that was the result of an audit designed in part to identify potential risks of loss or mishandling of consumer funds. The parties sought a solution that would not result in increased costs or the need for multiple engagements. However, the inability of a CPA to provide an unqualified opinion with respect to procedures defined by a third

party hindered the Department's ability to accept a single CPA engagement for all the procedures under Rule 1741.5. Consequently, the proposed revisions to the rule require two engagements, with the opinion and findings of each engagement to cumulatively represent the annual report required by section 17406 of the Escrow Law.

C. The Expansion of Businesses Currently Doing Business Within the State

The Commissioner has determined that this regulatory proposal will not result in the expansion of businesses, in particular escrow agents, currently doing business in California. The regulatory proposal will address the current compliance issue with CPA professional standards. Interested parties notified the Commissioner that the existing rule sets forth procedures for a CPA to follow in the annual audit of the licensee, which if accompanied by an unqualified opinion would result in the CPA violating the professional accounting principles. In particular, the provisions of Rule 1741.5 that dictate the procedures for a CPA to follow may only be performed under an agreed-upon procedures engagement and may result in findings regarding the procedures performed. However, the CPA may not provide an unqualified opinion on audit procedures not established under the CPA's own professional judgment.

To address these concerns, the Commissioner is proposing revisions to Rule 1741.5 in this rulemaking to provide that a licensee must engage a CPA to submit an unqualified opinion regarding the financial statements and supplementary information of the licensee, and a report of findings regarding the agreed-upon procedures set forth in the rule. Cumulatively, the reports will constitute the annual audit report and additional information authorized under section 17406 of the Escrow Law. These proposed amendments to the current rule will resolve the law's conflict with CPA professional standards and allow them to submit annual audit reports on behalf of escrow agent licensees, as required by current law. There is no indication that this rule will result in the expansion of businesses in California.

D. The Benefits of the Regulations to the Health and Welfare of California Residents, Worker Safety and the State's Environment

The Commissioner has determined that this regulatory proposal may benefit the health and welfare of California residents by increasing protections for individuals who use escrow agent services through requiring consistent information in escrow agents' annual audit reports, which will enable the Commissioner to better assess the condition of the companies and be alerted to any issues with trust account funds. As a result, the Commissioner will be better able to address trust account issues and protect the trust funds placed with escrow agents by the public. The regulatory proposal does not benefit worker safety or the state's environment.

Technical, Theoretical and/or Empirical Studies and Reports [Gov. Code, § 11346.2, subd.(b)(3)]

In proposing the amendment and adoption of the regulations contained in this rulemaking, the Department relied on the American Institute of Certified Public Accountants (AICPA) Statement on Accounting Standards (SAS) (or alternatively

Statements on Standards for Attestation Engagements (SSAE)) These included the following documents:

(1) AICPA issued Standards for Attestation Engagements (SSAE) No. 18 (SSAE-18) in April 2016, for agreed-upon procedures reports effective on or after May 1, 2017. The link for SSAE-18 is found at: https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-no-18.pdf

(2) AICPA issued Standards for Attestation Engagements (SSAE) No. 19 (SSAE-19) on December 19, 2019 which supersedes SSAE-18 effective for agreed-upon procedures reports dated on or after July 15, 2021. The link for SSAE-19 is found at: https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-19.pdf

Reasonable Alternatives [Gov. Code, § 11346.2, subd. (b)(4)]

No reasonable alternative to these regulations has been identified or brought to the Department's attention that would be less burdensome and equally effective in carrying out the purpose for which the action is proposed, other than the proposal described in this Initial Statement of Reasons. The Department sought input from interested parties on July 24, 2013, on alternative approaches that would not require multiple engagements with a CPA. The Department considered alternative approaches that would not require multiple engagements. However, no alternative was identified that would allow for an unqualified opinion with respect to the results of the audit procedures defined in the regulation.

Reasonable Alternatives That Would Lessen Any Adverse Impact on Small Businesses and Reasons for Rejecting Those Alternatives [Gov. Code, §11346.2, subd. (b)(4)(B)]

No reasonable alternative considered by the Department, or that has otherwise been identified and brought to the attention of the Department, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small business. Based on information and belief, the Commissioner has determined that an escrow agent is not a small business within the meaning of Government Code section 11342.610, subdivision (b). Therefore, this rulemaking action does not impact small businesses.

Facts, Evidence. Documents, Testimony or Other Evidence Relied Upon [Gov. Code, § 11346.2, subd. (b)(5)]

In determining that this action will not have a significant adverse economic impact on business, the Department has relied upon the fact that the revisions to the rule in this rulemaking action do not include any additional audit procedures.